



0000101134

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

**COMMISSIONERS**

KRISTIN K. MAYES, Chairman

GARY PIERCE

PAUL NEWMAN

SANDRA D. KENNEDY

BOB STUMP

AZ CORP COMMISSION  
DOCKET CONTROL

2009 JUL 29 P 4: 42

IN THE MATTER OF THE UNS GAS, INC.  
FOR THE ESTABLISHMENT OF JUST AND  
REASONABLE RATES AND CHARGES  
DESIGNED TO REALIZE A REASONABLE  
RATE OF RETURN ON THE FAIR VALUE  
OF THE PROPERTIES OF UNS GAS, INC.  
DEVOTED TO ITS OPERATIONS  
THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. G-04204A-08-0571

**STAFF'S NOTICE OF FILING  
SURREBUTTAL TESTIMONY**

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files the Surrebuttal Testimony of Staff Witnesses Dr. Thomas H. Fish, David C. Parcell, Rita R. Beale, and Robert G. Gray in the above-referenced matter.

RESPECTFULLY SUBMITTED this 29<sup>th</sup> day of July, 2009.

Robin R. Mitchell, Attorney  
Kevin O. Torrey, Attorney  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007  
(602) 542-3402

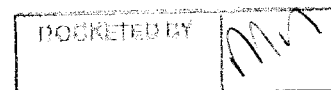
Arizona Corporation Commission

DOCKETED

JUL 29 2009

Original and thirteen (13) copies  
of the foregoing were filed this  
29<sup>th</sup> day of July, 2009 with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007



1 Copy of the foregoing mailed and/or  
2 sent via email this 29<sup>th</sup> day of July, 2009 to:

3 Raymond S. Heyman  
4 Phillip J. Dion  
5 Michelle Livengood  
6 UNISOURCE ENERGY SERVICES  
7 One South Church Avenue, Suite 200  
8 Tucson, Arizona 85701  
9 [rheyman@uns.com](mailto:rheyman@uns.com)  
10 [pdion@tep.com](mailto:pdion@tep.com)  
11 [mlivengood@tep.com](mailto:mlivengood@tep.com)

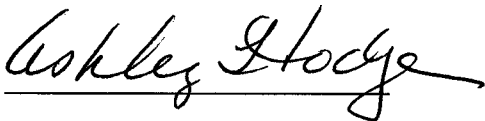
12 Michel W. Patten  
13 Jason D. Gellman  
14 ROSHKA DEWULF & PATTEN, PLC  
15 One Arizona Center  
16 400 East Van Buren Street, Suite 800  
17 Phoenix, Arizona 85004  
18 [mpatten@rdp-law.com](mailto:mpatten@rdp-law.com)  
19 [tsabo@rdp-law.com](mailto:tsabo@rdp-law.com)  
20 [mippolito@rdp-law.com](mailto:mippolito@rdp-law.com)

21 Daniel Pozefsky, Chief Counsel  
22 RESIDENTIAL UTILITY CONSUMER OFFICE  
23 1110 West Washington Street, Suite 220  
24 Phoenix, Arizona 85007  
25 [dpozefsky@azruco.gov](mailto:dpozefsky@azruco.gov)

26 Copy of the foregoing mailed this  
27 29<sup>th</sup> day of July, 2009 to:

28 Nicholas J. Enoch  
Jarrett J. Haskovec  
LUBIN & ENOCH, P.C.  
349 North Fourth Avenue  
Phoenix, Arizona 85003  
Attorneys for IBEW Local 1116

Cynthia Zwick  
1940 East Luke Avenue  
Phoenix, Arizona 85016

24  
25 

**SURREBUTTAL  
TESTIMONY  
OF**

**DR. THOMAS H. FISH  
DAVID C. PARCELL  
RITA R. BEALE  
ROBERT G. GRAY**

**DOCKET NO. G-04204A-08-0571**

**IN THE MATTER OF THE APPLICATION OF  
UNS GAS, INC. FOR THE ESTABLISHMENT  
OF JUST AND REASONABLE RATES AND  
CHARGES DESIGNED TO REALIZE A  
REASONABLE RATE OF RETURN ON THE  
FAIR VALUE OF THE PROPERTIES OF UNS  
GAS, INC. DEVOTED TO ITS OPERATIONS  
THROUGHOUT THE STATE OF ARIZONA**

**JULY 29, 2009**

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES

Chairman

GARY PIERCE

Commissioner

PAUL NEWMAN

Commissioner

SANDRA D. KENNEDY

Commissioner

BOB STUMP

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
UNS GAS, INC. FOR THE ESTABLISHMENT )  
OF JUST AND REASONABLE RATES AND )  
CHARGES DESIGNED TO REALIZE A )  
REASONABLE RATE OF RETURN ON THE )  
FAIR VALUE OF THE PROPERTIES OF UNS )  
GAS, INC. DEVOTED TO ITS OPERATIONS )  
THROUGHOUT THE STATE OF ARIZONA )

DOCKET NO. G-04204A-08-0571

SURREBUTTAL

TESTIMONY

OF

THOMAS H. FISH, PH.D.

ON BEHALF OF

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2009

## TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
RATE BASE ADJUSTMENTS .....	1
Post-Test Year Plant .....	1
Customer Advances Adjustment.....	3
Working Capital.....	3
Reconstruction Cost New Depreciated ("RCND") Study.....	5
Customer Class Risk Study.....	8
Accumulated Deferred Income Taxes ("ADIT").....	8
OPERATING INCOME ADJUSTMENTS.....	9
Rate Case Revenue Annualization .....	9
Customer Annualization .....	9
Customer Growth.....	11
Weather Normalization .....	14
Fair Value Component of Revenue Requirement .....	14
OPERATING EXPENSE ADJUSTMENTS.....	15
Payroll Tax Expense .....	15
Incentive Compensation.....	15
AGA Dues.....	16
Postage Expense.....	16
Normalize Outside Legal Expenses .....	17
Bad Debt Expense.....	17
Fleet Fuel Expense.....	18
Call Center .....	19
Synchronized Interest.....	20
Income Taxes .....	20

**EXECUTIVE SUMMARY**  
**UNS GAS, INC.**  
**DOCKET NO. G-04204A-08-0571**

My Surrebuttal Testimony addresses the Company's proposed revenue requirement and pro forma adjustments to rate base and operating revenue. I also respond to the Rebuttal testimony of UNS Gas, Inc. witnesses Hutchens, Grant, Erdwurm, Dukes, and Kissinger.

Staff now recommends a revised total operating income of \$13,236,581, with an associated operating income deficiency of \$2,166,054, and a gross revenue requirement of \$3,539,982.

	Original	Surrebuttal
	Pro Forma	Modified Pro
Description	Adjustment	Forma Adjustment
	Rate Base Pro Forma Adjustment	
ADIT	\$38,994	0
	Revenue Pro Forma Adjustments	
Payroll Tax	\$(11,739)	\$(8,780)
Postage	\$(49,594)	\$(49,247)
AGA Dues	\$(1,614)	0
SERP	\$(310,412)	\$(101,021)
Fuel Expense	\$(308,381)	\$(226,352)
Synchronized Interest	\$54,906	0
Bad Debt	\$(186,625)	\$(185,927)
Operating revenue deficiency	\$2,077,601	\$2,166,054
Increase in gross revenue requirement	\$3,395,423	\$3,539,982

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. Thomas H. Fish. I am president of Ariadair Economics Group, 1020 Fredericksburg Rd.  
4 Excelsior Springs, MO 64024.  
5

6 **Q. Are you the same Thomas H. Fish who filed direct testimony in this case on behalf of**  
7 **the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division**  
8 **Staff ("Staff")?**

9 A. Yes.  
10

11 **Q. What is the purpose of your Surrebuttal testimony?**

12 A. The purpose of my testimony is to respond to selected issues that were presented in the  
13 Rebuttal Testimony of UNS Gas, Inc. ("UNS Gas" or "UNS") witnesses Hutchens, Grant,  
14 Erdworm, Dukes, and Kissinger.  
15

16 **RATE BASE ADJUSTMENTS**

17 **Post-Test Year Plant**

18 **Q. Did Staff propose a pro forma adjustment for Post-Test Year Plant in Service?**

19 A. Yes. The Company proposed a pro forma adjustment to place \$1,527,588 of post-test year  
20 Plant in Service in rate base. Staff offered a pro forma adjustment to remove that amount  
21 from the Company's proposed rate base.  
22

23 **Q. Did the Company, in its Rebuttal Testimony, respond to Staff's proposed removal of**  
24 **its post-test year Plant in Service?**

25 A. Yes.  
26

1 **Q. What was the Company's response?**

2 A. The Company witness, Mr. Dukes, proposed that certain post-test year Plant in Service  
3 should remain in rate base. He stated (page 5, lines 6-8 of his Rebuttal Testimony) that  
4 "The Plant accounting group and operational personnel of UNS Gas reviewed the projects  
5 and identified investments that had been made in projects that would not produce  
6 additional revenue and that would have been invested in regardless of customer growth."  
7 The Company argues that it is not fair to have made the capital investment, which the  
8 Company alleges is necessary for the provision of service and, due to unfortunate timing,  
9 not be allowed to include it in rate base.

10  
11 **Q. Is the inclusion of post-test year plant up to the discretion of the Commission?**

12 A. Yes. There are specific instances where the Commission has allowed a utility to include  
13 post-test year plant in rate base. Typically, Staff does not recommend the inclusion of  
14 post-test year plant in rate base.

15  
16 **Q. Are there instances where Staff has recommended the inclusion of post-test year  
17 plant?**

18 A. Although Staff typically does not recommend the inclusion of post-test year plant in rate  
19 base unless the utility has demonstrated a compelling need, Staff has recognized the  
20 following situations that may warrant the inclusion of post-test-year plant:

- 21 • When the magnitude of the investment relative to the utility's total investment is such  
22 that not including the post-test year plant in the cost of service would jeopardize the  
23 utility's financial health;
- 24 • When the cost of the post-test year plant is significant and substantial;
- 25 • The net impact on revenue and expenses for the post-test year plant is known and  
26 insignificant, or is revenue neutral; and



- The post-test year plant is prudent and necessary for the provision of services and reflects appropriate, efficient, effective and timely decision-making.

**Q. Are there other problems with allowing the inclusion of post-test year plant?**

**A.** Yes. Post-test year plant is usually mismatched with the revenues, expenses and the rate base of the test year. Revenues and expenses associated with post-test year plant are not quantifiable and thus create the mismatch.

#### **Customer Advances Adjustment**

**Q. Does Staff agree with the Company's rationale regarding customer advances?**

**A.** No. Customer advances represent non-investor-supplied capital and as such they should be reflected as a deduction to rate base. In addition, A.A.C. R-14-2-103 requires that those funds be deducted from rate base.

#### **Working Capital**

**Q. Please describe Staff's cash working capital pro forma adjustment.**

**A.** Staff noticed an anomaly in the Company's payment to British Petroleum ("BP") that reduced the payment day lag to only 17.83 days for three months, not the normal 35 days. The lag for payment for purchased gas reduced the average monthly payment lag to 27.89 days. Staff made a corresponding adjustment to account for the reduction in the average payment lag and for the impact of the other proposed adjustments to operating revenue and expenses which resulted in an adjustment to working capital requirements of \$(1,624,840).

1 **Q. Did the Company address Staff's cash working capital pro forma adjustment in its**  
2 **Rebuttal Testimony?**

3 A. Yes. In his Rebuttal Testimony, Mr. Dukes made an additional cash working capital  
4 adjustment from his original \$97,967 to \$2,183,948. On page 8, lines 14-19, Mr. Dukes  
5 states:

6  
7 "The payment lag is actually much shorter than the 35 days used by Staff. In fact, the  
8 payments made to that vendor early in the test year were not reflective of payment terms  
9 later in the test year or of the current payment terms. The Company's payment terms were  
10 altered during the test year because of credit limitations. The vendor now requires the  
11 Company to make payments twice a month and those payment requirements continue  
12 today and for the foreseeable future."

13  
14 Mr. Dukes goes on to say, page 8, lines 23-27:

15  
16 "In the Company's original filing, the new payment terms were only partially reflected in  
17 the Company's lead lag study. The changed payment schedule remains in place and is  
18 therefore a "known and measurable" change. Thus the Company is making an alternative  
19 adjustment in its rebuttal filing to fully reflect all purchased gas payments to that vendor  
20 with the proper payment lags."

21  
22 **Q. Should the Company's rate payers be responsible for the incremental cost of**  
23 **purchased gas associated with the timing of the payments?**

24 A. No. Staff's position is that the Company's 12-day payments (including 7.5 day mid-point  
25 correction) is not realistic and is not representative of normal credit terms. Although the  
26 Company may accept these terms from BP, such terms are not normal or reasonable. UNS  
27 has the discretion to obtain more favorable terms and conditions from another supplier.

**Reconstruction Cost New Depreciated ("RCND") Study**

**Q. How does the Company describe Staff's analysis and evaluation of its RCND study?**

A. The Company has alleged that Staff mischaracterized its RCND study in the prior rate case (Docket No. G-04204A-06-0463 et al.) as being conservative when it was not. Company witness Dukes (Rebuttal Testimony at page 9, lines 4-11) states:

"Dr. Fish incorrectly implies in his Direct Testimony (at page 13, lines 1-11) that the Company took an extremely conservative approach in deriving its RCND study in the last rate case to keep the value of the RCND down. In fact, if the present RCND was done in this case consistent with the prior case, the Company would have presented an RCND value of approximately \$22.2 million (this amount was subsequently reduced to \$16 million) greater than the one filed in my Direct Testimony. Therefore, the Company took a more conservative approach in this filing when compared to the previous filing."

**Q. Do you agree with Mr. Dukes interpretation of your evaluation of the Company's RCND Study?**

A. No.

**Q. Please explain.**

A. The Company made several errors in its previous study which resulted in an understatement of the RCND rate base. The Company has used an extremely aggressive approach to calculating its trend values for Mains (Federal Energy Regulatory Commission ("FERC") account 376) and for Services (FERC account 380) in its RCND study in this proceeding.

The value (purchasing power) of money changes over time so that dollars to be received in the future can generally be expected to have less value than today's dollars and dollars received in the past can generally be expected to have had greater value than today's dollars. This is an important concept, since a fundamental step in a RCND study is the

1 initial one of making all dollars spent on a utility system have the same value. The initial  
2 task is to create what the Company calls "trend values" which, as explained in my Direct  
3 Testimony, are created by dividing the ending index value (base period value) by each of  
4 the series of index values in the study. The validity of the trend value depends upon the  
5 analyst making sure that the base index value (test year) is chosen correctly.

6  
7 In the previous RCND study, the Company used the wrong base period. Thus, the RCND  
8 value in the previous case was understated by about 25 percent, which, in turn, understated  
9 the fair value rate base by about 12.5 percent. In the RCND study the Company  
10 conducted for this case, it does not appear that the Company made the same mistake of  
11 using the wrong base period value to derive trend values.

12  
13 **Q. Do you have additional information you would like to provide?**

14 A. Yes. In my telephone discussion with Mr. Dukes in May 2009, I asked, with regard to the  
15 RCND study in the prior rate case, why the Company did not separate out the Mains  
16 (FERC 376) by plastic, steel, and cast iron, since those indices are available from Handy-  
17 Whitman. I also asked why the Company labeled the index column Handy-Whitman  
18 Index, Section G-5, Line 43 (cast iron) but used Line 44 (steel) values. Mr. Dukes  
19 explained that when the assets of Citizens Utilities were acquired by UniSource, Citizens'  
20 records were scattered. He said that the Citizens office in New Orleans was searched for  
21 accounting records and that the search was extended to include the garages of Citizens  
22 employees in New Orleans. As a result of the poor record keeping by Citizens, the  
23 Company simply did not have the detailed records that would allow a precise  
24 determination of RCND at that detailed level to be made. Mr. Dukes explained that as a  
25 consequence the Company tried to take a conservative approach in its RCND study effort.  
26 In my opinion, under those conditions, a conservative approach was probably best.

1     **Q.     Why do you conclude that the Company is using an aggressive approach in this**  
2     **RCND study?**

3     A.     The Company claims that if its RCND study in this case were consistent with that of the  
4     previous case, the value of the RCND would be approximately \$22 million (amended to  
5     \$16 million) greater than the one filed. Unfortunately, Mr. Dukes did not define what he  
6     meant by the word "consistent." If the Company had used the same procedure as in its  
7     previous rate case, its RCND would have been smaller than the one presented because in  
8     the last rate case the Company used a base index in the year before the test year, not the  
9     index in the test year. In the RCND study presented in this case, the base index the  
10    Company used for Mains (steel) was 565 and in the previous year it was 555. The  
11    calculated trend values would have been smaller and the resulting reconstructed values  
12    also smaller had the Company made the same error (been consistent with) the procedure  
13    used in the previous case.

14  
15    In addition, the Handy-Whitman index values for January 1, 2008 for Cast Iron Mains was  
16    472, for Steel Mains was 565, and for plastic Mains was 438. The Company applied the  
17    index value for Steel Mains to its entire system, and the index value for Steel Mains was  
18    18 percent above that of Cast Iron Mains and 29 percent above that of Plastic Mains.  
19    Since FERC 376 is such a large component of rate base, unless the Company really does  
20    have 100 percent Steel Mains, it has surely overstated RCND rate base and, by extension,  
21    Fair Value Rate base. (Note that Handy-Whitman provided only cast iron and steel index  
22    values for FERC Account 376 until 1962 when it started to provide an index value for  
23    Plastic Mains in addition to steel and cast iron.) But since, according to Mr. Dukes, the  
24    Company does not have the records necessary for precise calculation, we cannot know for  
25    sure.  
26

**Customer Class Risk Study**

**Q. Does the Company address Staff's customer class risk study in its Rebuttal Testimony?**

A. Yes. Company witness Erdworm (Rebuttal Testimony at page 14, lines 1-2) complains that the customer class study "...contains no usable sensitivity analysis, and as presented, only serves to obscure the degree of financial risk this Company faces."

**Q. Do you agree with Mr. Erdworm's criticism of Staff's customer class risk study?**

A. No. The customer class risk study was designed to capture unanticipated changes in consumption, not as a sensitivity analysis of the Company's financial risk. This was accomplished by combining classical time series analysis with a comparable coefficient of variation analysis. The study was not designed to address the financial risk of the Company. The Company could have conducted a sensitivity analysis of its financial risk and presented its results. It apparently chose not to do so.

**Accumulated Deferred Income Taxes ("ADIT")**

**Q. Did the Company address Staff's adjustment for ADIT?**

A. Yes. Company witness Kissinger stated at page 2, lines 2-7 of her Rebuttal Testimony that the amount disallowed by Staff was not included in the rate base in the Company's Application and, therefore, should not be disallowed.

**Q. Does Staff agree with the Company's assertions?**

A. Yes. Staff adjusted ADIT to recognize the income tax effects of the Supplemental Executive Retirement Plan ("SERP") adjustment.

**OPERATING INCOME ADJUSTMENTS**

**Rate Case Revenue Annualization**

**Q. Does the Company address your Rate Case Revenue Annualization adjustment in its Rebuttal Testimony?**

**A. Yes. Mr. Erdworm states at page 10, line 24 through page 11, line 3:**

“Moreover, the flaws in Dr. Fish’s rate case revenue annualization are compounded; the revenue annualization does not fully adjust test-year revenue for the rate change that occurred within the test-year. It appears that Dr. Fish’s adjustment is improperly limited to his overstated customer growth estimate. A rate case annualization adjustment should apply to all test-year sales – not just growth – billed prior to the “within-the-test-year” rate change.”

**Q. Do you agree with Mr. Erdworm’s criticism?**

**A. No. Staff believes that its methodology is accurate and appropriate. Please see my direct testimony at pages 22-23.**

**Customer Annualization**

**Q. Does the Company agree with Staff’s customer annualization technique and outcome?**

**A. No. The Company alleges that Staff’s annualization is flawed.**

**Q. What are the reasons that the Company gives to support its claim that Staff’s annualization method is flawed?**

**A. Company witness Erdworm at page 4, lines 11-20 of his Rebuttal Testimony gives the following reasons for his conclusion that Staff’s customer annualization is flawed:**

1. It adjusts customer counts to levels exceeding not only test-year end, but all months of the test-year, even months beyond the test-year.

2. Applies a future test-year approach to the customer annualization adjustment without applying future test-year methods to all other aspects of the ratemaking process – and thus violates the “matching principle”.
3. Uses a significantly overstated and unsupportable customer count growth rate.
4. Fails to adjust customer count to test-year end levels.
5. Is not known and measurable because it uses customer levels that still have not been attained and will not be attained until some unknowable date in the future.

**Q. Do you agree with Mr. Erdworm’s conclusions?**

A. No.

**Q. Can you please address Mr. Erdworm’s allegations?**

A. Staff responds as follows:

- Staff’s customer annualization adjustment creates test year customers that reflect a level of operating revenues and expenses and net plant investment that is representative of normal conditions that may be expected to exist during the time that resulting rates will be in effect.
- Staff did not apply a future test-year approach to its customer annualization method, as suggested by the Company. Staff utilized historical test year information as provided by the Company.
- Staff used the growth rate provided by the Company.
- Staff did not fail to adjust customer count to test year end levels. Company witness Erdworm in his Direct Testimony explicitly states that the number of test-year bills should not necessarily equal the exact year-end customer count.



- The Company does not require that year end customer counts for annualization purposes be equal to actual year end customer counts. Therefore, if matching of year-end customer counts with annualization counts is not required for customer annualization purposes.

**Q. Does the Company recognize problems with its approach to customer annualization?**

A. Yes. According to Mr. Erdwurm, the Company recognized that its customer annualization procedure resulted in invalid and unusable results. "Of the test-year ends during the summer (as in this case June 2008), the test-year end customer count may be less than some of the monthly customer counts during the previous eleven months of the year." (Erdwurm Direct Testimony at page 8, lines 3-5.) In this case, 8 of the previous 11 months had higher customer counts (for R10) and were adjusted downwards by the Company.

#### **Customer Growth**

**Q. Has the Company presented an inconsistent position with respect to customer growth and the impact on its capital investment?**

A. Yes. Company witness Hutchens stated in his Direct Testimony (page 6, lines 19-24):

"As I previously mentioned, UNS Gas has put an additional \$54 million of capital investment into service on its distribution and service line facilities since the end of its last rate case test year. Roughly two-thirds of this significant investment has been related to growth in the Company's natural gas system in a number of service area communities in Arizona. The remaining one-third is attributable to UNS Gas' need to upgrade and reinforce its system for existing customers."

Thus, approximately \$36 million of the capital investment base is directly associated with customer growth, and about \$18 million of the capital investment is for existing

1 customers. However, other Company witnesses present conflicting information with  
2 respect to customer growth.

3  
4 **Q. What conflicting information has the Company presented?**

5 A. Company witness Erdwurm makes the following statements regarding customer growth:  
6 "Customer levels that (referring to Staff's customer annualization) still have not been  
7 attained and will not be attained *until some unknowable date in the future.*" (At page 4,  
8 lines 19-20, emphasis added.) "Dr. Fish's inflated customer count has not yet been  
9 achieved by July 8, 2009 and will not be achieved *until some indeterminate time in*  
10 *achieved until far after the test-year. . .*" (At page 5, lines 17-18) "There has been no  
11 "major customer addition" . . ." (At page 6, line 8) " . . .more than a year after the close of  
12 the test-year, UNS Gas has not reached this inflated customer count *and may not reach it*  
13 *for some significant time to come.*" (At page 6, lines 21-22, emphasis added.) The  
14 Company further states in Mr. Edwurm's testimony: "Dr. Fish should never have pressed  
15 forward with his methodology, since he should have known the customer level to which  
16 he was adjusting had never occurred, *nor would it occur, even over a period one year after*  
17 *the end of the test year.*" (At page 7, lines 22-25, emphasis added.) It appears that the  
18 Company has changed its position from a growing system to a no-growth system since  
19 this rate application was filed.

20  
21 **Q. Does the Company offer support that it has no customer growth?**

22 A. Yes. The Company seems to be reversing its position on customer growth and has  
23 decided that it does not know when customer growth may actually reach customer  
24 annualization levels of the test year. To support this position, Mr. Erdwurm provides two  
25 tables: Residential rate R10 customer counts (Exhibit DBE-3, pages 1 and 2) and  
26 Commercial rate C20 customer counts (Exhibit DBE-3, pages 5 and 6). Mr. Erdwurm

1 uses these schedules as support for his contention that there is no customer growth on the  
2 UNS Gas System. He shows that the May 2009 R10 customer bill count was 124,203,  
3 down from the December 2006 count of 125,383, and the May 2009 C20 count of 11,356  
4 was down from the December 2006 count of 11,435.  
5

6 **Q. What conclusions do you reach from this information provided by the Company?**

7 A. It is clear that existing customers are being asked to pay for \$36 million in capital  
8 investment that is not necessary for the Company's provision of service to them. That  
9 investment, according to the Company, was made to provide service to customers who do  
10 not exist and, according to the Company, may or may not exist at some time in the future.  
11 Staff requested information concerning the Company's capital investment and  
12 depreciation as well as for monthly customer count by rate group, but the Company did  
13 not provide it in response to Staff's data request.(See the Company response to Staff data  
14 requests TF 6.4 and TF 6.5, also Staff response to Company request UNSG 4.23). This  
15 investment, according to the Company, certainly cannot be considered to be used and  
16 useful in the provision of service to the Company's remaining customers. It appears that  
17 there is no customer benefit to the investment because the growth did not materialize.  
18

19 **Q. Are there other factors that might be considered in evaluating the \$36 million capital**  
20 **investment made for customer growth that has failed to materialize?**

21 A. Yes. After the Company filed its application for rate relief, the economy took a turn for  
22 the worse. The residential real estate market suffered a setback, various financial sectors  
23 of the economy experienced some reversals, and the rate of growth in the number of the  
24 Company's customers appears to have slowed. The Company appears to have not forecast  
25 and considered these factors in making its capital investment decisions related to customer  
26 growth.

**Weather Normalization**

**Q. Did the Company address Staff's weather normalization adjustment?**

A. Yes. Mr. Erdwurm, in his Rebuttal testimony at page 10, lines 22-24, argues that since Staff's customer annualization is flawed, Staff's weather normalization must have flaws as well.

**Q. Do you agree with Mr. Erdwurm's assessment?**

A. No. Staff's customer annualization, as demonstrated in detail above, is correct. Because Staff's customer annualization is correct, Staff's weather normalization adjustment is correct.

**Fair Value Component of Revenue Requirement**

**Q. Does the Company address Staff's treatment of Fair Value in your Schedule THF-A1?**

A. Yes. At page 29, lines 3-4 of Company witness Grant's Rebuttal Testimony, Mr. Grant states that "Indeed, even Staff seems to concede that this (0 percent return on fair value increment) is inappropriate. He contends that Staff's revenue requirement does not follow Mr. Parcell's "primary recommendation" and he cites Schedule THF-A1. The Staff fair value adjustment of Schedule THF-A1 is not a comment on the process involved in deriving the fair value adjustment, but simply follows the direction of Staff witness Parcell with respect to incorporating Mr. Parcell's fair value adjustment into the Company's revenue requirement in that Schedule.

**OPERATING EXPENSE ADJUSTMENTS**

**Payroll Tax Expense**

**Q. Dr. Fish, do you propose a modification to the pro forma payroll tax expense adjustment?**

**A.** Yes. Schedule THF – C16 shows line No. 1 referring to Schedule THF – C12. The correct reference should be Schedule THF – C14. In addition, the correct adjustment should be \$8,981, not \$11,739.

**Incentive Compensation**

**Q. Did the Company address Staff's pro forma adjustments for employee incentive compensation in its Rebuttal Testimony?**

**A.** Yes. Mr. Dukes, at pages 12 through 15, suggests that the Company be allowed to recover all of the PEP incentive compensation. Staff had made a pro forma adjustment of one half of PEP expenses because the benefits accrued to both ratepayers and owners of the Company.

**Q. Do you agree with Mr. Dukes that the Company should be allowed to recover all of its PEP expenses in rates?**

**A.** No. Mr. Dukes does not provide evidence that ratepayers enjoy all of the benefits associated with PEP.

**Q. Does the Company take exception to Staff's pro forma adjustment for SERP in its Rebuttal Testimony?**

**A.** Yes. SERP is a supplemental retirement plan for select employees that exceed IRS retirement limits. Staff recommended that those expenses be eliminated from revenue requirement. Mr. Dukes, at page 18, lines 22-24 states: "It simply keeps those individuals

1           whose compensation level exceeds deductibility levels equal to those individuals whose  
2           compensation does not.”

3  
4       **Q.    Do you agree with Mr. Dukes’ arguments to include SERP expenses in rates?**

5       A.    No. Staff does not advocate that the SERP plan not be available to Company executives  
6           only that owners, not ratepayers, fund it.

7  
8       **Q.    Do you propose a modification for Staff’s SERP adjustment?**

9       A.    Yes. The original adjustment was \$310,412. The amount was taken from the Company’s  
10          lead lag study work papers. That amount, however, included both SERP and PEP  
11          expenses and, therefore, overstated the SERP expense. The SERP expense should be  
12          \$101,021.

13  
14       **AGA Dues**

15       **Q.    Did the Company address Staff’s adjustment for membership dues for the American**  
16       **Gas Association (“AGA”)?**

17       A.    Yes. Mr. Dukes, of page 21 of his rebuttal testimony, stated that Staff’s adjustment was  
18           unnecessary.

19  
20       **Q.    Do you agree?**

21       A.    Yes. The AGA Dues pro forma adjustment of \$1,614 should be eliminated.

22  
23       **Postage Expense**

24       **Q.    Was there a mathematical error in Staff’s postage expense pro forma adjustment?**

25       A.    Yes. Staff’s customer annualization resulted in 34,440 more customer bills than the  
26          Company’s customer annualization. These additional customers would require postage

1 for their bills. Two cents of the total postage for the additional customers is accounted for  
2 in line 3 of Schedule THF – C9, but \$0.42 of the postage for the additional customers is  
3 not accounted for and should be. This amount is \$14,465. The total postage pro forma  
4 adjustment, then, is \$34,782 from line 3 plus \$14,465 for a total pro forma adjustment of  
5 \$49,247, not \$49,594.

6  
7 **Normalize Outside Legal Expenses**

8 **Q. Did the Company claim that Staff erred in its pro forma adjustment for legal**  
9 **expenses?**

10 A. Yes. Mr. Dukes, at page 27 of his Rebuttal Testimony, claims that Staff provided no  
11 substantive reason for the pro forma adjustment.

12  
13 **Q. Do you agree?**

14 A. No. Mr. Dukes has provided no substantive reasons for the high level of legal expenses he  
15 seeks nor has the Company offered any evidence that it is attempting to mitigate its legal  
16 expense. Absent this evidence by the Company, Staff's pro forma adjustment should be  
17 accepted by the Commission.

18  
19 **Bad Debt Expense**

20 **Q. Does the Company address Staff's proposed bad debt expense in its Rebuttal**  
21 **Testimony?**

22 A. Yes. The Company claims that Staff is in error because Staff's pro forma adjustment  
23 corrects for an over-reserved amount for bad debt amount that does not exist. Therefore,  
24 according to Mr. Dukes, Staff's proposed pro forma adjustment should be rejected by the  
25 Commission.

1 **Q. What was the status of the Company's accounts receivable and allowance for**  
2 **doubtful accounts at the time of its filing?**

3 A. At the time of its filing, the Company's Billed Accounts Receivable was \$7,085,000 per  
4 their June 30, 2008 balance sheet. At that time, the allowance for doubtful accounts was  
5 \$1,220,000 or over 17 percent of Billed Accounts Receivable. That amount had increased  
6 from \$366,000 in 2005, which is an increase of over 300 percent.

7  
8 **Q. Does Mr. Dukes consider the allowance for doubtful accounts of 17 percent of billed**  
9 **accounts receivable to be reasonable?**

10 A. Allowance for bad debts is the net difference of bad debt expense accruals and realized  
11 losses. Mr. Dukes suggests that he takes offense that Staff might question the  
12 appropriateness of the reserve for bad debt, but he believes it is perfectly reasonable to fail  
13 to recognize losses in a timely fashion. The accumulated reserve for bad debt is 200  
14 percent of test year bad debts and certainly should not be considered reasonable.

15  
16 **Fleet Fuel Expense**

17 **Q. Do you propose a correction to Staff's fleet fuel expense?**

18 A. Yes. The pro forma adjustment was calculated by subtracting test year gallons times  
19 current price per gallon from test year gallons times test year price to derive the  
20 adjustment of \$294,599. However, an arithmetic error was made in multiplying test year  
21 gallons times current price. The incorrect amount was shown as \$450,747, and it should  
22 have been \$437,027. So the pro forma adjustment should have been \$308,381 rather than  
23 \$294,599 as shown on Schedule THF – C8.



1 **Q. Is the correct pro forma fuel expense adjustment \$308,381?**

2 A. No. In providing the fleet fuel expense, the Company actually provided fleet fuel *cost*.  
3 Fleet cost, according to the Company, exceeds fuel expense because a portion of it is  
4 capitalized to capital projects. Because 26.6 percent of fuel cost is capitalized and  
5 assigned to capital projects associated with the fuel usage and the remainder is fuel  
6 expense, the fleet fuel expense adjustment should be reduced by 26.6 percent to \$226,352.  
7

8 **Call Center**

9 **Q. Did the Company question Staff's pro forma adjustment for call center expense?**

10 A. Yes. At pages 22 to 25, Mr. Dukes criticizes this adjustment. He suggests that call center  
11 usage was poorly measured and that if the Company had its own call center rather than  
12 sharing one with its sister companies that the cost would be higher.  
13

14 **Q. Do you agree with Mr. Dukes' argument?**

15 A. No. Staff is not suggesting that the Company create its own call center. The issue really  
16 is not the allocation method, but that call center costs seem to be increasing at an alarming  
17 rate. The sizable increase in costs associated with the Call Center, and the apparent lack  
18 of justification for these cost increases, suggest that the Company may not be controlling  
19 costs as it should. Absent support for the increase in call center expenses, the Company  
20 should not be granted permission to recover those expenses. According to Mr. Erdwurm's  
21 Schedules with his Rebuttal Testimony, the Company's customer count has declined since  
22 the end of the previous test year.

1     **Synchronized Interest**

2     **Q.     Do you have a proposed correction to make for Staff's pro forma synchronized**  
3         **interest adjustment?**

4     A.     Yes. In its simultaneous equation work paper the Company makes an adjustment for  
5         synchronized interest. Therefore Staff's pro forma adjustment is not required.

6  
7     **Income Taxes**

8     **Q.     Do you make an adjustment for income taxes?**

9     A.     Yes. Income taxes are recalculations made on the basis of other adjustments.

10  
11    **Q.     Does that conclude your surrebuttal testimony?**

12    A.     Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES

Chairman

GARY PIERCE

Commissioner

PAUL NEWMAN

Commissioner

SANDRA D. KENNEDY

Commissioner

BOB STUMP

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
UNS GAS, INC. FOR THE ESTABLISHMENT )  
OF JUST AND REASONABLE RATES AND )  
CHARGES DESIGNED TO REALIZE A )  
REASONABLE RATE OF RETURN ON THE )  
FAIR VALUE OF THE PROPERTIES OF UNS )  
GAS, INC. DEVOTED TO ITS OPERATIONS )  
THROUGHOUT THE STATE OF ARIZONA. )

---

DOCKET NO. G-04204A-08-0571

SURREBUTTAL

TESTIMONY

OF

DAVID C. PARCELL

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JULY 29, 2009

**EXECUTIVE SUMMARY**  
**UNS GAS, INC.**  
**DOCKET NO. G-04204A-08-0571**

My Surrebuttal testimony is in response to the rebuttal testimony of UNS Gas, Inc. ("UNS Gas") witness Kentton C. Grant. My Surrebuttal testimony responds to the following general areas of Mr. Grant's rebuttal testimony: cost of common equity, ability of UNS Gas to earn its cost of capital and Fair Value Rate of Return.

## **TABLE OF CONTENTS**

	<b><u>Page</u></b>
INTRODUCTION .....	1
COST OF COMMON EQUITY .....	2
ABILITY OF UNS GAS TO EARN ITS COST OF CAPITAL .....	7
RATE OF RETURN ON FAIR VALUE RATE BASE .....	7

**INTRODUCTION**

**Q. Please state your name, occupation, and business address.**

A. My name is David C. Parcell. I am President and Senior Economist of Technical Associates, Inc. My business address is Suite 601, 1051 East Cary Street, Richmond, Virginia 23219.

**Q. Are you the same David C. Parcell who filed direct testimony on behalf of the Utilities Division Staff earlier in this proceeding?**

A. Yes, I am.

**Q. What is the purpose of your current testimony?**

A. My current testimony is surrebuttal testimony in response to the rebuttal testimony of UNS Gas, Inc. ("UNS Gas") witness Kentton C. Grant.

**Q. What aspects of Mr. Grant's rebuttal testimony do you respond to in this surrebuttal testimony?**

A. My surrebuttal testimony responds to the following general areas of Mr. Grant's rebuttal testimony:

Cost of Common Equity;

Ability of UNS Gas to Earn its Cost of Capital; and

Fair Value Rate of Return

**COST OF COMMON EQUITY**

**Q. Mr. Grant claims, on page 1, that your cost of equity recommendation falls “well below the actual cost of equity to UNS Gas.” What is your response to this assertion?**

A. I believe that my cost of equity recommendation is appropriate for UNS Gas at this time. This cost of equity recommendation is based upon the results of my Discounted Cash Flow (“DCF”), Capital Asset Pricing Model (“CAPM”) and Comparable Earnings (“CE”) analyses and has been performed in a similar fashion to my recent testimonies before this Commission. I note that my 10.0 percent recommendation matches the cost of equity that the Commission found appropriate for UNS Gas in its most recent proceeding (i.e., Docket No. G-04204A-06-0463). There has been no demonstration that the cost of capital has increased since the 2007 proceeding of UNS Gas. I also note that this Commission determined that 10.0 percent was the fair cost of equity for Southwest Gas in a 2008 proceeding (Docket No. G-01551A-07-0504), which was applied to a lower percentage of common equity than is the case for UNS Gas in the current proceeding.

**Q. Mr. Grant also maintains, on pages 1-2, that your testimony does not “properly take into account the substantial deterioration in capital market conditions and increase to the cost of capital that has occurred since September of 2008.” Do you agree with this claim?**

A. No, I do not. I demonstrated in my direct testimony, on pages 14-15 and 38-40, that the events since September of 2008 largely reflect the “flight to safety” that accompanied the unprecedented (in recent memory) decline in the equity markets as a result of the collapse of the subprime mortgage market and the ultimate near-meltdown in the financial system. The events of the last two years have impacted virtually all aspects of the economy and society, not just utilities and UNS Gas. The customers of UNS Gas have also been adversely impacted by these same conditions, in terms of lay-offs, decline in real estate

1 values, disintegration of the values of IRAs/401Ks, and the other implications of the  
2 severe recession in Arizona. Another aspect of this economic/financial decline is lower  
3 returns earned (if even positive) by competitive firms in both Arizona and the U.S. This  
4 decline reflects a reduction in the opportunity cost of capital, not an increase as proposed  
5 by Mr. Grant.

6  
7 **Q. Mr. Grant claims, on page 4, that each of your three cost of equity analyses “contain**  
8 **significant flaws that serve to significantly understate the cost of equity capital to**  
9 **UNS Gas.” What is your response to this?**

10 A. I disagree with Mr. Grant. The analyses that I use have been presented to this  
11 Commission several times in recent years and my recommendations, including those for  
12 UNS Gas and UNS Electric, have been accepted by the Commission.

13  
14 **Q. Mr. Grant maintains, on pages 4-6, that the CAPM model, and in particular the**  
15 **historic risk premium component, “is not applicable in today’s capital markets.” He**  
16 **also claims, on page 8, that your CAPM risk-free rate reflects the “flight to safety”**  
17 **but you did not “adjust” the market risk premium. What is your response to these**  
18 **assertions?**

19 A. It is apparent that the CAPM results are lower than the DCF results, as well as being lower  
20 than CAPM results in recent years. The two reasons for the lower CAPM results are the  
21 current relatively low yields on U.S. Treasury bonds (i.e., risk-free rate) and a lower risk  
22 premium that reflects the decline in stock prices in 2008. However, these currently lower  
23 CAPM results are only one-half of the impact of recent economic conditions. The other  
24 impact is on the DCF results which are somewhat higher currently due to the higher yields  
25 attributable to the decline in stock prices. It would not be proper to disregard the lower  
26 CAPM results while not discounting the higher DCF results.



1 **Q. On pages 5-7, Mr. Grant claims that investors are more “risk averse” and that**  
2 **spreads between government and corporate/utility yields are demonstrative of an**  
3 **increased cost of capital for utilities and UNS Gas. Do you agree with this?**

4 **A.** No, I do not. As I indicated in my direct testimony, most of this increase in yield spreads  
5 results from the “flight to safety” that resulted from the decline in the equity markets (i.e.,  
6 some 40 percent decline) that left investors unwilling to invest in common stocks at this  
7 time. This reflects more of an “availability of capital” as I indicated on pages 14-15 of my  
8 direct testimony. In addition, as Mr. Grant acknowledges on page 7, utility stocks have  
9 fared better than most common stocks during this time, again reflecting a “flight to  
10 safety.”

11  
12 **Q. Mr. Grant further maintains, on pages 9-10, that your use of both geometric and**  
13 **arithmetic means in your CAPM analysis is not proper. What is your response to**  
14 **this?**

15 **A.** It is apparent that investors have access to both types of returns and correspondingly use  
16 both types of returns, when they make investment decisions. In fact, it is noteworthy that  
17 mutual fund investors regularly receive reports on their own funds, as well as prospective  
18 funds they are considering investing in that show only geometric returns. Based on this, I  
19 find it difficult to accept Mr. Grant’s position that only arithmetic returns are considered  
20 by investors and, thus, only arithmetic returns are appropriate in a CAPM context. I note  
21 that I provided additional comments on this point in my direct testimony.

22  
23 **Q. Has this Commission recently made a finding as to whether it is appropriate to use**  
24 **geometric as well as arithmetic returns in this context?**

25 **A.** Yes, it has. In Decision No. 70360, in the recent UNS Electric case (Docket No. E-  
26 04204A-06-0783) the Commission specifically stated (page 43) that it agreed with the use

1 of geometric returns in this manner: "We agree with the Staff that it is appropriate to  
2 consider the geometric returns in calculating a comparable company CAPM because to do  
3 otherwise would fail to give recognition to the fact that many investors have access to  
4 such information for purposes of making investment decisions."

5  
6 **Q. Mr. Grant indicates his belief, on page 10, that "income returns" (which he uses) is**  
7 **superior to "total returns" (which you use). What is your response to this?**

8 A. I addressed this issue in my direct testimony on page 42.  
9

10 **Q. On pages 11-13, Mr. Grant takes issue with the growth rates you examine in your**  
11 **DCF analyses. What is your response to this?**

12 A. Mr. Grant maintains that the growth rates I examine in my DCF analyses are too low to  
13 reflect investor expectations. In making this assertion, he relies heavily on his perception  
14 that I used the "average" of the five sets of growth rates in reaching my conclusions.  
15 However, as an examination of page 28 of my direct testimony reveals, my 9.5 percent to  
16 10.5 percent conclusion includes DCF rates using most of the individual growth rates, not  
17 just the average. Whereas, I did not give much weight to the "outliers" of growth rates for  
18 the proxy group, my conclusion incorporates all of the individual growth rates for Mr.  
19 Grant's proxy group.  
20

21 I also note that the existence of "low" growth rates does not imply that investors do not  
22 give consideration to these in reaching their investment decisions. This is especially true  
23 in the recent and current economic environment where the recovery of both the economy  
24 and earnings growth rates is problematic at best. Nevertheless, as I indicate in my direct  
25 testimony, I do not give weight to the low "outlier" growth rates in my DCF conclusions.  
26

1 **Q. Mr. Grant suggests, on page 13, that you should have added an additional 1.5**  
2 **percent to the growth rates in your DCF analyses. Do you agree with that assertion?**

3 A. No, it would not be appropriate to include/add 1.5 percent to the growth rates. Investors  
4 may desire higher growth rates, but they have no right to expect them if such an  
5 expectation is not supported by data or realistic information.  
6

7 **Q. Mr. Grant also criticizes your comparable earnings analyses on page 14. What is**  
8 **your response to this position?**

9 A. I disagree with Mr. Grant. The book value of UNS Gas' capital, including common  
10 equity, is used to determine the Company's cost of capital. It is only natural that the  
11 returns on book value of equity (i.e., comparable earnings analyses) is an appropriate  
12 mechanism for estimating the cost of equity. Mr. Grant also claims that this Commission  
13 has rejected the comparable earnings approach. I note that I am not aware of any cases in  
14 which I have appeared that the Commission has reached this conclusion.  
15

16 **Q. Mr. Grant also maintains, on page 15, that market-to-book ratios do not indicate**  
17 **investor acceptance of earned returns. Is he correct?**

18 A. No, he is not. Stock prices – one component of the market-to-book ratio – reflect all  
19 relevant information. For public utilities, the return on equity is a major component of the  
20 rate-setting process and clearly is reflected in stock prices, and thus market-to-book ratios.  
21 I also note that I consider expected returns on equity in my comparable earnings analysis.

1 **Q. On page 17, Mr. Grant claims to have “recalculated” your cost of equity results. Is**  
2 **this a proper exercise?**

3 A. No, it is not. Mr. Grant’s “recalculations” are simply his attempt to interject his DCF,  
4 CAPM, and CE components into my analyses. Such recalculations are incorrect and  
5 improper.  
6

7 **ABILITY OF UNS GAS TO EARN ITS COST OF CAPITAL**

8 **Q. Mr. Grant devotes several pages of his rebuttal testimony to his assertion that UNS**  
9 **Gas will not likely earn the cost of capital authorized in this proceeding. Is this a**  
10 **proper criticism of your direct testimony?**

11 A. I do not believe it is proper rebuttal to my testimony. Mr. Grant seems to be taking the  
12 position that the cost of capital authorized by a commission should be regarded as a  
13 “guarantee” but this is not the case. Utility investors have no more “right” to a guaranteed  
14 return than do its ratepayers to a “right” to employment, maintenance of their housing  
15 values, and an increasing value of their retirement accounts and other investments.  
16

17 **RATE OF RETURN ON FAIR VALUE RATE BASE**

18 **Q. Mr. Grant maintains, on page 28, that your Fair Value Rate of Return (“FVROR”)**  
19 **recommendation to apply a zero percent return to the Fair Value Increment**  
20 **amounts to a “backing in” method of assigning a FVROR. Do you agree with his**  
21 **assessment?**

22 A. No, I do not. My proposal specifically recognizes the value of the Fair Value Rate Base  
23 (“FVRB”) increment and applies the actual cost of this capital (which is zero) to it. As  
24 such, I believe this proposal specifically recognizes and utilizes the FVRB in establishing  
25 rates.

1 **Q. Mr. Grant also claims, on pages 28-30, that since the Commission did not adopt your**  
2 **FVROR proposal in the Chaparral City remand proceeding (Docket No. W-02113A-**  
3 **04-0616) that your proposal has been “rejected.” What is your response to this?**

4 A. I note, first of all, that the FVROR proposal of Chaparral City was the same as that  
5 proposed by UNS Gas and UNS Electric in their 2007 rate proceedings (Docket Nos. G-  
6 04204A-06-0463 and E-04204A-06-0783), namely that the original cost rate of return be  
7 applied the level of FVRB. In all three of these cases, the Commission did not adopt the  
8 Chaparral City/UNS Gas & Electric position. In the UNS Gas and UNS Electric cases, the  
9 Commission did adopt my recommendation. It is my reading of the Chaparral City  
10 remand order by the Commission that a similar procedure to that which I recommended  
11 was adopted.

12  
13 I also note that the Commission noted in its Chaparral City remand order “we also believe  
14 that Staff’s method is an appropriate way to adjust the Weighted Average Cost of Capital  
15 associated with the Original Cost Rate Base for use with the FVRB, as it is based on  
16 sound economic and financial theory.

17  
18 **Q. What is the basis of the 6.80 percent FVROR recommended by Mr. Grant?**

19 A. This is not apparent from Mr. Grant’s direct or rebuttal testimonies. Mr. Grant’s only  
20 guidance as to UNS Gas’ derivation of the 6.80 percent FVROR is that its “reduction  
21 (from a 7.30 percent value that the Company apparently believes could have been  
22 requested) was a voluntary measure.”

23  
24 **Q. Does this conclude your Surrebuttal Testimony?**

25 A. Yes, it does.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

KRISTIN K. MAYES  
Chairman  
GARY PIERCE  
Commissioner  
PAUL NEWMAN  
Commissioner  
SANDRA D. KENNEDY  
Commissioner  
BOB STUMP  
Commissioner

IN THE MATTER OF THE APPLICATION OF	)	DOCKET NO. G-04204A-08-0571
UNS GAS, INC. FOR THE ESTABLISHMENT	)	
OF JUST AND REASONABLE RATES AND	)	
CHARGES DESIGNED TO REALIZE A	)	
REASONABLE RATE OF RETURN ON THE	)	
FAIR VALUE OF THE PROPERTIES OF UNS	)	
GAS, INC. DEVOTED TO ITS OPERATIONS	)	
THROUGHOUT THE STATE OF ARIZONA.	)	
<hr/>		

SURREBUTTAL

TESTIMONY

OF

RITA R. BEALE

ON BEHALF OF THE STAFF OF THE  
ARIZONA CORPORATION COMMISSION

JULY 29, 2009

**TABLE OF CONTENTS**

	<u>Page</u>
INTRODUCTION .....	1
SUMMARY OF SURREBUTTAL .....	1
SURREBUTTAL TESTIMONY .....	2

**EXHIBITS**

Jan 2010 Physical Flow Forecast.....	1
--------------------------------------	---

**EXECUTIVE SUMMARY**  
**UNS GAS, INC.**  
**DOCKET NO. G-04204A-08-0571**

In April and May 2008, I conducted a prudency review of the gas procurement operations of UNS Gas Inc. ("UNS Gas") My testimony focused on the period from January 2006 to June 2008, with nine findings and also ten recommendations for the Commissioners to consider. In his rebuttal testimony, Mr. Hutchens accepted and concurred with all of my ten recommendations, however his additional comments suggested that he did not fully understand several recommendations. I felt it was necessary to clarify the nature of recommendations numbered 1, 2, 5 and 6. My ten recommendations are:

- (1) UNS Gas should conduct a thorough analysis of excess interstate pipeline capacity that could be currently optimized through Asset Management Arrangements (AMA).
- (2) If excess pipeline capacity is available, UNS Gas should have Tucson Electric Power ("TEP"), seek potential counterparties on UNS Gas' behalf, at least annually, to optimize all of its excess capacity on both Transwestern and also on El Paso Pipeline, although not at the expense of incurring a net increase in El Paso charges and penalties.
- (3) UNS Gas should be required to supplement the information filed monthly to the Commission to tie out and support all entries of the Purchased Gas Adjustor Bank Balance, and specifically to include the *UNS Gas Core Market/ System Supply Imbalance Report* which finalizes tie-out of the commodity balances by pipeline.
- (4) To ensure accuracy of the PGA filings, personnel from the Energy Settlements and Billing Department should receive additional training in the operating practices and terminology used by TEP Wholesale Department for gas procurement.
- (5) The *UNS Gas Inc. Price Stabilization Policy* should be changed to require consideration of purchases during the three excluded months of August, September and October. Automatically excluding these months created missed opportunities to buy lower-priced gas during 2006, 2007 and 2008.
- (6) To increase its hedge documentation, UNS Gas should create a record indicating the months that management decides to deviate from a ratable purchasing pattern,<sup>1</sup> even if it as simple as using a checklist denoting 'management decided not to hedge'.
- (7) The *UNS Gas Inc. Price Stabilization Policy* should also be amended for any changes to gas purchasing strategy changes effective September 2008, when TEP took over gas procurement.
- (8) The *UNS Gas Inc. Price Stabilization Policy* must be updated at least annually to reflect current practices and procedures.
- (9) All parties involved with gas procurement should acknowledge the *UNS Gas Inc. Price Stabilization Policy* by signing annually, including Gas Scheduling, Transportation Contracts, Risk Management, and Risk Control; not just the traders.

---

<sup>1</sup> The *UNS Gas Inc. Price Stabilization Policy* essentially sets a non-discretionary portion of forecasted gas load (minimum 45 percent) to be hedged with fixed price instruments at ratable quantities of 1/27th over 27 different months leading up to the physical flow month, excluding August, September and October.



- (10) A single person should be assigned as the 'policy owner' of the *UNS Gas Inc. Price Stabilization Policy* to ensure, on an annual basis, that the policy is accurate before it is approved by the Corporate Risk Management Committee.

**INTRODUCTION**

**Q. Please state your name, occupation, and business address.**

A. My name is Rita Regina Beale. I am a consultant employed with Energy Ventures Analysis, Inc. ("EVA"). My business address is 1901 N. Moore Street, Suite 1200, Arlington, VA 22209-1706.

**Q. What is the purpose of your Surrebuttal Testimony?**

A. The purpose of my Surrebuttal is to respond to the Rebuttal Testimony of David Hutchens of UNS Gas Corporation ("UNS" or "Company") as it relates to my Direct Testimony.

**Q. On whose behalf are you appearing?**

A. I am appearing on behalf of the Arizona Corporation Commission ("ACC" or Commission") Utilities Division Staff.

**Q. How is your testimony organized?**

A. I have additional comments to David Hutchen's response to my recommendations numbered 1, 2, 5 and 6.

**SUMMARY OF SURREBUTTAL**

**Q. Please summarize the relevant UNS Rebuttal Testimony.**

A. In his rebuttal testimony, Mr. Hutchens accepted and concurred with all of my recommendations, however his additional explanations suggested to me that he did not fully understand my recommendations, and I felt it was necessary to clarify the nature of the recommendations.

**SURREBUTTAL TESTIMONY**

**Q. What would you like to clarify for recommendations numbers 1 & 2?**

A. UNS Gas seems to be doing a fine job on offering excess capacity on the brand new Transwestern Pipeline in the form of Asset Management Arrangements ("AMA"). However my recommendation was to extend similar efforts to optimize all excess capacity on existing El Paso Pipeline and Transwestern Pipeline contracts, as well. Mr. Hutchens discussed the AMA for the brand new Transwestern Pipeline capacity and did not acknowledge the other existing contracts.

**Q. What would you like to clarify for recommendation number 5?**

A. UNS Gas' current policy is ineffective and causes rate payers to miss the opportunity to buy low price gas. My recommendation is to formally change the hedge policy and now require non-discretionary purchases in the months of August, September, and October. As with other months of the year, the portfolio manager should continue to have the option of seeking management approval not to execute the non-discretionary hedges in those months. Mr. Hutchens stated that UNS Gas would consider evaluating opportunities during the traditional hurricane months, which is a different concept.

**Q. What would you like to clarify for recommendation number 6?**

A. For its discretionary hedges, a review of all existing hedge documentation suggests that UNS seems to be doing a good job of documenting Risk Management Committee approvals by email, but conversely, a fairly poor job of documenting changes to its non-discretionary hedges. In the system of record from which transactions and trade patterns are analyzed, there is no notation of whether a transaction is discretionary or non-discretionary, so perhaps such notation could be accommodated in the system. Sorting all hedge transactions by either a flow month, or conversely by trade execution date, leaves

nothing in the record to explain all of the variations from an expected pattern, of which there are many. There also is no apparent tie to the forecasted volumes. Exhibit 1 is offered as an example of what the hedge documentation might look like.

Exhibit 1:

**Hedge Record**

**Physical Flow Forecast, Jan 2010**

		2,346,377		
		50% Target		
		1,173,189		
Trade Execution	Month	Amount Hedged	Cumulative	Hedge Notes
	Dec-06	32,589	32,589	Done. 1/36 of remaining
	Jan-07	32,589	65,177	Done. 1/35 of remaining
	Feb-07	32,589	97,766	Done. 1/34 of remaining
	Mar-07	80,000	177,766	RMC approval for higher volume
	Apr-07	32,125	209,891	Done. 1/32 of remaining
	May-07	0	209,891	RMC approval to wait
	Jun-07	33,196	243,087	Done. 1/30 of remaining
	Jul-07	33,196	276,283	Done. 1/29 of remaining
	Aug-07	33,196	309,480	Done. 1/28 of remaining
	Sep-07	33,196	342,676	Done. 1/27 of remaining
	Oct-07	33,196	375,872	Done. 1/26 of remaining
	Nov-07	33,196	409,068	Done. 1/25 of remaining
	Dec-07	28,063	437,132	Corporate forecast changed to 2,100,000
	Jan-08	28,063	465,195	Done. 1/23 of remaining
	Feb-08	28,063	493,258	Done. 1/22 of remaining
	Mar-08	28,063	521,322	Done. 1/24 of remaining
	Apr-08	28,063	549,385	Done. 1/25 of remaining
	May-08	60,000	609,385	RMC approval for higher volume
	Jun-08	60,000	669,385	RMC approval for higher volume
	Jul-08	60,000	729,385	RMC approval for higher volume
	Aug-08	-	729,385	RMC approval to wait
	Sep-08	-	729,385	RMC approval to wait
	Oct-08	-	729,385	RMC approval to wait
	Nov-08	-	729,385	RMC approval to wait
	Dec-08	29,434	758,819	Done. 1/12 of remaining
	Jan-09	29,434	788,252	Done. 1/11 of remaining
	Feb-09	29,434	817,686	Done. 1/10 of remaining
	Mar-09	60,000	877,686	RMC approval for higher volume
	Apr-09	60,000	937,686	RMC approval for higher volume
	May-09	60,000	997,686	RMC approval for higher volume
	Jun-09	60,000	1,057,686	RMC approval for higher volume
	Jul-09	60,000	1,117,686	RMC approval for higher volume
	Aug-09	50,000	1,167,686	RMC approval for higher volume
	Sep-09			=56% of Forecasted Load
	Oct-09			
	Nov-09			Hedge must be completed

1     **Q.     Please summarize your additional findings.**

2     A.     My findings are that UNS Gas concurred with my ten recommendations and may have  
3           needed some additional clarification on numbers 1, 2, 5 and 6 provided in this surrebuttal.

4

5     **Q.     Does this conclude your surrebuttal testimony?**

6     A.     Yes, it does.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

KRISTIN K. MAYES

Chairman

GARY PIERCE

Commissioner

PAUL NEWMAN

Commissioner

SANDRA D. KENNEDY

Commissioner

BOB STUMP

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
UNS GAS, INC. FOR THE ESTABLISHMENT )  
OF JUST AND REASONABLE RATES AND )  
CHARGES DESIGNED TO REALIZE A )  
REASONABLE RATE OF RETURN ON THE )  
FAIR VALUE OF THE PROPERTIES OF UNS )  
GAS, INC. DEVOTED TO ITS OPERATIONS )  
THROUGHOUT THE STATE OF ARIZONA. )  
\_\_\_\_\_ )

DOCKET NO. G-04204A-08-0571

SURREBUTTAL

TESTIMONY

OF

ROBERT G. GRAY

EXECUTIVE CONSULTANT III

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2009

## TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
PURCHASED GAS ADJUSTOR .....	1

**EXECUTIVE SUMMARY  
UNS GAS INC.  
DOCKET NO. G-04204A-08-0571**

My surrebuttal testimony in this proceeding addresses UNS Gas Inc.' (UNS) Witness Kentton Grant's rebuttal testimony regarding the application of interest to the purchased gas adjustor ("PGA") bank balance.



**INTRODUCTION**

**Q. Please state your name, occupation, and business address.**

A. My name is Robert G. Gray. I am an Executive Consultant III employed by the Arizona Corporation Commission in the Utilities Division. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

**Q. Are you the same Robert Gray that filed direct testimony in this proceeding?**

A. Yes.

**Q. What is the scope of this surrebuttal testimony?**

A. My surrebuttal testimony provides Staff's comments on UNS Gas Inc. ("UNS") Witness Grant's rebuttal testimony regarding interest applied to the Purchased Gas Adjustor ("PGA") bank balance.

**PURCHASED GAS ADJUSTOR**

**Q. Please comment on Mr. Grant's rebuttal testimony.**

A. Mr. Grant's rebuttal testimony provides some clarification regarding possible sources for the London Interbank Offered Rate interest rate which UNS has proposed for adoption in this proceeding as well as discussing the possible application of several different interest rates to the PGA bank balance.

**Q. Having reviewed Mr. Grant's rebuttal testimony, are there any changes to Staff's recommendations regarding the interest rate to be applied to the PGA bank balance?**

A. No. For the reasons contained in Staff's direct testimony, Staff continues to believe the current interest rate should be retained.

1    **Q.    Do you have any further comments regarding the application of interest to the PGA**  
2    **bank balance?**

3    A.    Yes. Mr. Grant's testimony focuses on the cost of borrowing for UNS in regard to the  
4    PGA bank balance, but in practice the PGA bank balance can be, and has been, both  
5    under-recovered and over-recovered at various times in its history. Thus the interest rate  
6    is currently, and should be in the future, applied symmetrically to cases where UNS is  
7    owed money by the ratepayers and where ratepayers are owed money by UNS.

8

9    **Q.    Does this conclude your surrebuttal testimony?**

10   A.    Yes, it does.